Decision 03-01-008 January 16, 2003

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Southern California Gas Company To Adopt Performance Based Regulation ("PBR") for Base Rates to be Effective January 1, 1997. (U 904 G)	Application 95-06-002 (Filed June 1, 1995; Petition for Modification filed October 29, 2002)

ORDER DENYING MODIFICATION OF DECISION 97-07-054

I. Summary

This decision denies Southern California Gas Company's (SoCalGas) petition to suspend its Performance Based Ratemaking (PBR) cost of capital trigger mechanism.

II. Background

Decision (D.) 97-07-054 authorized SoCalGas to implement a PBR procedure effective January 1, 1998. An integral component of that PBR is a mechanism that requires SoCalGas to change its authorized Return on Equity (ROE), Return on Rate Base (ROR) and rates upon the activation of a trigger. That trigger activates upon a 150 basis point change in the 6.95% benchmark interest rate as measured simultaneously by the 12-month trailing average of 30-Year Treasury Bonds and Data Resources, Inc. (DRI) 12-month forward forecast of 30-Year Treasury Bond yields.[1] Hence, the trigger activates when the

[1] One basis point equals 0.01%.

interest rate change reaches 5.45% (6.95% less 150 basis points) on the downside and 8.45% (6.95% plus 150 basis points) on the upside. On activation, SoCalGas is to adjust its ROE, ROR and rates based on a fixed formula in its Market Indexed Capital Adjustment Mechanism (MICAM).[2]

In October 2002, Treasury Bonds 12-month trailing average dropped to 5.38% and the DRI 12-month future forecast dropped to 5.31%, thereby activating the trigger. This activation resulted in SoCalGas filing an Advice Letter to reduce its authorized ROE to 10.82% from 11.60%, ROR to 8.70% from 9.49%, and its rates by $9.578 million beginning January 1, 2003.[3]

III. Issue

The issue is whether the cost of capital trigger mechanism (trigger mechanism) should be suspended.

A. SoCalGas

SoCalGas seeks to forgo its trigger mechanism which otherwise would cause a reduction in its authorized ROE, ROR and rates at this time, as set forth in its Advice Letter 3199. It does so on the basis that the Treasury Bonds benchmark is not comparable to the yields on SoCalGas' debt, utility bonds in general, or general corporate bonds.

SoCalGas submitted the declaration and analysis of a Sempra Energy Principal Financial Analyst to support its position.[4] That declaration states that

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[2] The MICAM provides for an adjustment in authorized ROE of one-half of the change in interest rates that triggered the mechanism and a true up to the current cost of preferred equity and debt.

[3] Advice Letter 3199 dated October 29, 2002.

[4] Sempra Energy is the parent company of SoCalGas.

30-Year Treasury Bond is not a valid benchmark because those bonds are no longer issued. The 30-Year Treasury Bond was last issued in February of 2001.

Its analysis shows a disproportionate relationship between SoCalGas' Series DD first mortgage bonds and Treasury Bonds (weighted between 30-year and 10-Year Treasury Bonds to approximate Series DD's remaining life). The analysis also shows a disproportionate relationship between 30-Year Treasury Bonds and an AA-rated utility bonds index over the past 20 years.

B. Protestants

Aglet Consumer Alliance and the Utility Reform Network jointly filed a protest. The Office of Ratepayer Advocates also filed a protest. These protests seek a denial of the petition on the basis that the trigger mechanism is only one component of the PBR package, SoCalGas has benefited from a constant 11.60% ROE since 1997, and denial of the petition would bring SoCalGas' ROE in line with other utilities' recently authorized ROEs.[5]

C. Discussion

SoCalGas seeks to forgo the trigger mechanism while keeping the remainder of its PBR operational. This proposal comes at a time when the mechanism has triggered, requiring a reduction in rates and more than a year after the Treasury's discontinuance of issuing long-term Treasury Bonds, the benchmark interest rate proposed by SoCalGas and adopted by the Commission.[6]

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[5] San Diego Gas & Electric Company and Sierra Pacific Power Company were authorized a 10.90% ROE for their 2003 test year, pursuant to D.02-11-027.

[6] 73 CPUC2d, 469 at 507 (1997).

The purpose of a PBR is to establish incentives to reduce costs, to pass some of the resulting savings onto ratepayers, and to reduce regulatory burdens. The disputed trigger mechanism was established so that shareholders and ratepayers of SoCalGas would share in the burden and benefit of interest rate changes while eliminating the regulatory burden of submitting cost of capital applications.

Use of 30-Year Treasury Bonds as a benchmark may be flawed. However, that benchmark, selected by SoCalGas, was established as one of several components of SoCalGas' PBR to benefit both shareholders and ratepayers. The suspension of a possible flaw does not necessarily mitigate the impact that such a flaw may have on the PBR. SoCalGas has not convinced us that suspension of the trigger mechanism will not adversely impact ratepayers.

Further, at the time the 11.60% ROE benchmark was set for SoCalGas, that same ROE was set for other major energy companies. Except for Southern California Edison Company, the authorized ROEs of the other energy utilities are currently lower than they were in 1997. For example, the Commission adopted a 2003 test year ROE of 11.22% for Pacific Gas and Electric Company and 10.90% for San Diego Gas & Electric Company and Sierra Pacific Power Company.[7] These lower ROEs do not support SoCalGas' request to maintain its ROE last set in 1997 and does not accomplish the intended result of the trigger mechanism.

We are not persuaded to forego the cost of capital component of SoCalGas' PBR. SoCalGas should address the merits of a replacement trigger mechanism as part of its December 2002 PBR/Cost of Service application with an

[7] D.02-11-027 dated November 7, 2002.

expected January 1, 2004 effective date. The petition is summarily denied, pursuant to Rule 47(h) of the Commission's Rules of Practice and Procedure.

IV. Comments on Draft Decision

The draft decision of the ALJ in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(g)(1) and Rule 77.7 of the Rules of Practice and Procedure. Comments received from SoCalGas were carefully reviewed and considered. To the extent such comments required discussion or changes to the draft decision, the discussion or changes have been incorporated into the body of this order.

V. Assignment of Proceeding

Henry Duque is the Assigned Commissioner and Michael Galvin is the assigned Administrative Law Judge (ALJ) in this proceeding.

Findings of Fact

1. SoCalGas' PBR requires it to adjust its authorized ROE, ROR, and rates upon activation of a cost of capital trigger.

2. The trigger mechanism is activated upon a 150 basis point change in the 6.95% benchmark interest rate as measured simultaneously by the 12-month average of 30-Year Treasury Bonds and DRI 12-month forward forecast of 30-Year Treasury Bonds yield.

3. The trigger mechanism was activated in October of 2002.

4. An advice letter was filed by SoCalGas to set its January 1, 2003 authorized ROE at 10.82% and its ROR at 8.70%, and to reduce its rates by $9.578 million.

5. The ROE resulting from SoCalGas' trigger mechanism is comparable with test year 2003 ROEs adopted for other energy utilities.

Conclusions of Law

1. SoCalGas should be treated no differently from the other California energy companies with regard to its ROE.

2. The petition should be denied.

3. This decision should be effective today to ensure the continued operation of its PBR cost of capital trigger mechanism.

IT IS ORDERED that:

1. The October 29, 2002 petition of Southern California Gas Company to modify Decision 97-07-054 is denied.

2. Application 95-06-002 is closed.

This order is effective today.

Dated January 16, 2003, at San Francisco, California.

MICHAEL R. PEEVEY
President
CARL W. WOOD
LORETTA M. LYNCH
GEOFFREY F. BROWN
SUSAN P. KENNEDY
Commissioners